

UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF NEW YORK

SECURITIES AND EXCHANGE COMMISSION,

Plaintiff,

v.

KEVIN CASSIDY, et al.,

Defendants.

08 Civ. 9961 (GBD)

08 Civ. 9962 (GBD)

09 Civ. 3677 (GBD)

09 Civ. 7557 (GBD)

Conference and Argument

New York, N.Y.

December 4, 2012

10:15 a.m.

Before:

HON. GEORGE B. DANIELS

District Judge

APPEARANCES

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Commission

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Commission

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1 (Case called)

2 THE COURT: As long as the court reporter has
3 everyone's appearance, there is no need to indicate it for the
4 record. Just indicate who is speaking for the court reporter
5 while you speak.

6 Let me first see where we are with regard to the
7 status of the all of the related cases. Then we can address
8 Mr. O'Connor's motion. Let me start with the SEC, Commodities
9 or SEC. What is the status from your perspective?

10 MR. WALFISH: Good morning, your Honor. Daniel
11 Walfish for the SEC. At the moment deposition discovery is
12 proceeding. It is going smoothly. We are trying to meet the
13 schedule that your Honor set at the last status conference on
14 May 31. Currently, the fact discovery cutoff is set for
15 February 1 of next year. That's also the date for making
16 expert disclosures.

17 We have been discussing internally that we may want to
18 seek a modest adjustment of that deadline, particularly for the
19 expert disclosures. We haven't had a chance to discuss that
20 with Mr. O'Connor, who is the only party that we are actively
21 adverse to at this point. We are confident hopefully that we
22 can work something out offline and submit that on consent. If
23 not, we will, of course, take up any dispute with the Court.

24 THE COURT: What is your general proposal at this
25 point?

1 MR. WALFISH: At this point I don't have a general
2 proposal, but our thought was that an extension of something
3 like 45 to 60 days might be in order.

4 THE COURT: Does anything else actively need to be
5 done with regard to any of the other cases other than Mr.
6 O'Connor?

7 MR. WALFISH: If you are asking me with respect to the
8 SEC's case, I can only really speak to the SEC's case. Nothing
9 else right now.

10 There is one other open item of business for your
11 Honor, I think, in addition to the motion, which is that we
12 have submitted a consent judgment for the Court's consideration
13 and approval with Optionable, Inc., another of the defendants.

14 THE COURT: I believe I signed that already yesterday,
15 so it should come up on ECF today. The clerk's office probably
16 has it.

17 Do I need to hear separately from the CFTC?

18 MS. RYAL: Christine Ryal for CFTC. On Friday we
19 filed a motion asking to Court to set a civil monetary penalty
20 amount for Mr. Cassidy, who is the last remaining defendant in
21 our action. I talked to Mr. Gelber about his briefing time,
22 and we have agreed, if the Court is OK with this, to his
23 replying a reply brief or response brief by January 16th.
24 Then, if a reply is in order, we would ask that we be allowed
25 to file that by January 31.

1 THE COURT: Let me hear from the defendants. Anyone
2 else have anything to add with regard to those issues?

3 What I would propose is that I will await the fully
4 submitted CFTC motion and you agree upon what you think is
5 appropriate in terms of the schedule with regard to all the
6 other cases in the meantime, particularly the O'Connor case. I
7 think it makes sense to, if I'm going to have the motion fully
8 submitted by the end of January, have a conference by the end
9 of February. We can address the motion, and then you can see
10 in terms of your schedule with regard to other discovery,
11 particularly with regard to expert discovery, where you are at
12 that point.

13 For now let's say 9:30 on the 28th of February, the
14 last day of February. Let's see where we are then. I may be
15 on trial starting that Monday for several weeks. If I'm on
16 trial, we won't be able to do much of substance, but just the
17 motion if it needs to be addressed further. Let me see where
18 we are at that point and see what the status is.

19 If for some reason we don't need to meet on that date,
20 let me know by letter what the status is, and then we can
21 adjust that schedule. I think that is probably what makes
22 sense at this point in terms of moving forward efficiently.

23 Is there anything else other than the O'Connor motion
24 that needs to be addressed?

25 MR. HERSHMAN: Your Honor were you addressing all

1 cases, including the BMO civil case?

2 THE COURT: Yes. I'm sorry, yes.

3 MR. HERSHMAN: Your Honor, if I could be heard briefly
4 on that. Scott Hershman, White & Case, for Joe Saab. We are
5 not on the same path as the SEC case. We are not a party to
6 the SEC case nor the CFTC case.

7 On the matter that we are a party to, which is only
8 the BMO action against Mr. Saab, there is significant discovery
9 to conduct still. BMO made a representation to the Court back
10 in May that it had produced all documents, and it turns out
11 that that representation was not correct. As recently as last
12 week, they continued to produce trading data which is
13 incredibly relevant and significant to our defense. They also
14 recently produced over 22,000 hours of uncategorized audiotapes
15 which we are in the process of listening to and reviewing.

16 So, we have significant discovery issues that we
17 intend to take up with BMO in meet-and-confers over the next
18 few weeks. I would recommend or suggest to the Court that we
19 continue to have those meet-and-confers with BMO and attempt in
20 good faith to resolve these issues, and if we can't, then to
21 proceed to put them before Magistrate Cott, who has been very
22 helpful in that regard, and perhaps report back to your Honor
23 at the February date on where we are.

24 In my estimation, your Honor, it's going to take us a
25 significant period of time to review all of this data that has

1 been produced to us recently, as I said, in the last few weeks.
2 It is a massive amount of data. Even though the number of
3 pages perhaps was not as great, the number of transactions
4 referenced in the period of time from 2005 to 2007 is huge. We
5 are finding an incredible amount of exculpatory material in
6 that data and on the audiotapes, and it is quite significant,
7 frankly, to our case.

8 That is one issue. The other issue relates to the
9 privilege log. There are over 25,000 items on BMO's privilege
10 log. We are in the process of perusing all of that, and we
11 will take that up with BMO if the Court permits as well. We
12 expect through meet-and-confers with BMO we should be able to
13 resolve issues there. If there is any tail left, we will take
14 that up with Magistrate Cott as well.

15 The concern I have is with the deposition schedule. I
16 know your Honor set a cutoff date of February 1st for the SEC
17 action, and the SEC now suggests that they are going to ask for
18 a short extension of that. But that deposition schedule will
19 not serve the civil case, the BMO civil case at all.

20 We would prefer to not have to take depositions twice.
21 I think that was your Honor's intent in trying to have the
22 cases proceed concurrently, but that is going to become
23 increasingly more difficult as we get closer to the conclusion
24 of the SEC matter when the civil matter with BMO is really in
25 the throes of significant discovery.

1 Perhaps if we can take that up in February as well,
2 when we can report to the Court where we are on all of these
3 open issues discoverywise, and then address the schedule going
4 forward, if that suits the Court, that would be fine with us as
5 well.

6 THE COURT: See if you can come to some agreement as
7 to how you want to proceed. Also see if you can resolve
8 whatever outstanding discovery issues there might be by no
9 later than the second week of January. If there are still
10 issues, you can lay them out clearly for Magistrate Judge Cott
11 so he can hopefully resolve those before we meet the next time
12 so we can go ahead and move forward.

13 To the extent that you can agree, it will probably not
14 be a problem, then I'll approve that. But get an understanding
15 right away where there is conflict so we can move forward
16 efficiently and see where we are by that time.

17 MR. HERSHMAN: Very well, your Honor. Thank you.

18 MR. LACK: Robert Lack for Bank of Montreal. The
19 matters Mr. Hershman raised, the issues, this is the first time
20 I heard them. He hasn't raised them with us. We are perfectly
21 willing to meet and confer with Mr. Saab's counsel on any
22 discovery issues that may arise.

23 It is true that BMO recently discovered there was
24 additional trading data that had not been produced, and we
25 produced it. We are in the process of searching for one more

1 year of additional data that we may be able to restore and
2 produce.

3 Mr. Hershman may have been under the misimpression
4 that the SEC cutoff applied to the BMO case. Your Honor never
5 applied a discovery cutoff to the BMO case. It makes sense to
6 have a later cutoff for the BMO case because there are more
7 issues in that case than in the SEC case. Mr. Saab, for
8 example, is not a defendant in the SEC case, so the issues
9 relating to him will not be necessary to be explored in the
10 SEC's discovery. There are also other issues in the BMO case
11 that do not overlap with the SEC's case.

12 Where the SEC has been taking depositions, we have, as
13 you urged us and directed us to do, had those depositions in
14 all cases at once. We have completed two of those depositions,
15 Mr. Cassidy and Mr. O'Connor, over the period of six days. We
16 have five additional days of depositions and two additional
17 witnesses scheduled in the near future. And we expect to
18 continue to coordinate with the SEC.

19 I agree with Mr. Hershman that a later discovery
20 cutoff will be necessary in the BMO case, and I'd be pleased to
21 discuss with him and other defense counsel what that cutoff
22 should be. As of now we don't have any issues for the Court to
23 resolve. The issues that Mr. Hershman raised would be
24 appropriately raised with Judge Cott if they could not be
25 resolved by the parties themselves.

1 THE COURT: The main thing is to have some
2 understanding among all the parties as to which relevant
3 depositions are still outstanding so you can come to some early
4 understanding about when is the appropriate time to take those
5 depositions. If there is disagreement about that, then I
6 imagine Judge Cott can resolve that right away. It seems to me
7 it doesn't reflect the document production as it is laid out;
8 it just affects how all the parties would be prepared for
9 depositions depending on what other depositions need to be
10 taken.

11 MR. LACK: That has been how the parties have handled
12 the depositions. They have noticed the depositions. If there
13 have been scheduling differences, they have been taken up with
14 Judge Cott and resolved. I would expect that to be the way it
15 would work going forward.

16 THE COURT: Thank you. Anyone else? Why don't we
17 proceed on that basis. I'll hear from the SEC and defendant
18 O'Connor with regard to that motion. Whoever else wants to
19 stick around can, but otherwise we will conclude for the rest
20 of you.

21 (Conference concluded)

22 (10:30 a.m.; counsel for SEC and Edward O'Connor
23 present)

24 THE COURT: Why don't I hear from Mr. Smith.

25 MR. SMITH: Yes, sir. Your Honor, it is our position

1 that in light of the Optionable consent which your Honor stated
2 that he signed last week, or yesterday, the claims against Mr.
3 O'Connor, the 10b-5 claims, must be dismissed as there cannot
4 be two primary violators. As Optionable has settled as a
5 primary violator and admitted such, in effect Mr. O'Connor
6 cannot be found liable for 10b-5 ultimately, and therefore
7 those claims must be dismissed.

8 The SEC doesn't cite any case law that supports its
9 position that there can be two primary violators. In fact,
10 although I didn't cite this case in my brief, the Janus Capital
11 case from the U.S. Supreme Court that was handed down last year
12 got rid of, effectively, aiding and abetting under 10b-5. It
13 is our position that the SEC is trying to resurrect aiding and
14 abetting under 10b-5 in order to proceed with its 10b-5 claims
15 against Mr. O'Connor.

16 That being said, the SEC actually concedes in its
17 position papers that O'Connor is not the primary violator,
18 which I point out in our reply brief, stating that it is
19 entirely possible that O'Connor would not be primarily liable.
20 And although O'Connor as an individual may not be primarily
21 liable for Optionable's misstatements to investors, the company
22 certainly would be.

23 It added Optionable as a party to its first amended
24 complaint in order to bring control person liability against
25 Mr. O'Connor. While we argue in our original memorandum that

1 there is case law that supports our position that you cannot do
2 so -- we can argue whether or not it can be pleaded in the
3 alternative -- we all know that ultimately Mr. O'Connor cannot
4 be found liable of both. He cannot be a control person or he
5 cannot be a primary violator.

6 What we have now before us is the settlement with
7 Optionable. It is our position that based on those facts,
8 based on Optionable's settlement with the SEC, they brought
9 Optionable into the case in their amended complaint in order to
10 hold them as the primary violator so they could assert a 20(a)
11 claim against our client, and based on that we would argue that
12 the 10b-5 claims be dismissed against Mr. O'Connor.

13 In addition, I would touch on the control liability
14 claims as stated in our brief. It is our position that control
15 has not been established just by virtue of Mr. O'Connor's
16 position. In addition, even if control was established, Mr.
17 O'Connor's testimony during his deposition clearly refuted the
18 SEC's arguments trying to establish him as a culpable
19 participant. It is clear that his participation, if any, was
20 tangential at best. We would also submit that those claims be
21 dismissed as well.

22 THE COURT: I think I understand your argument, but
23 I'm not sure that it is completely accurate to say one cannot
24 be liable individually directly and liable as a control person
25 at the same time. I think the law is that you can't be held

1 liable at the same time for the same conduct.

2 So the question really is two questions. One is
3 whether or not they have a sufficient basis to plead in the
4 alternative. I would agree with you that you can't be a
5 primary violator and a control person violator based on the
6 same conduct.

7 Isn't the real question whether or not (1) they have a
8 basis to plead it in the alternative and (2) whether or not
9 there is separate individual conduct that supports a primary
10 violation which is different than the conduct that supports the
11 control person?

12 MR. SMITH: First, your Honor, I would submit that
13 there is not different conduct, that it is the same conduct
14 that they are alleging in the 10b-5 claims against O'Connor as
15 well as the control person.

16 THE COURT: How would you define that conduct at
17 issue? What is it that you say they allege happened that would
18 constitute both Optionable's violation and at the same time Mr.
19 O'Connor's individually?

20 MR. SMITH: They allege involvement in what they refer
21 to as a U-turn scheme, which I stated in our reply brief is a
22 statement that was made up by the SEC. It is not a term of art
23 in the industry. I submit that that term is used to color the
24 Court's view of what our client's actual involvement was, if
25 any. I am aware that our first motion to dismiss was denied,

holding up the 10b-5 claims.

THE COURT: Why isn't that law of the case at this point? They haven't taken anything out in the amended complaint. They have added more.

MR. SMITH: The settlement with Optionable has a clear effect on that issue.

THE COURT: It may have a clear effect on whether or not O'Connor can also be found liable either as a primary violator or a control person. Clearly, it doesn't affect whether he was a control person, what Optionable admitted was their conduct. The question is whether he is a control person still. How does that preclude or decide the issue of whether he was a control person?

MR. SMITH: I don't believe we are arguing that it precludes. What I am arguing is that in light of Optionable consenting to essentially violating 10b-5 and appealing to the Court's reason. There is no definitive case law out there.

The SEC cited cases that are completely inapposite in their surreply. It cites a bankruptcy case where the bank entered a guilty plea and they tried to impute the employees that were acting in the scope of their employment. It doesn't have anything to do with securities fraud. They are trying to appeal the agency law there.

To the issue of the settling defendant, the cases they cite, there was an issue of standing as to whether the

1 nonsettling defendant can appeal the settlement. We are not
2 appealing the settling with Optionable.

3 THE COURT: I don't understand how the admission of
4 securities fraud by Optionable would preclude a finding of
5 liability by anyone else who participated in it.

6 MR. SMITH: I'm not saying that it precludes a
7 finding. What I'm saying is that Optionable's consent to
8 violating 10b-5 makes it a primary violator.

9 THE COURT: Makes it a primary violator. It doesn't
10 necessarily mean that someone else didn't also primarily
11 violate. Somebody could have been made their own independent,
12 and that is part of what they allege, that Mr. O'Connor made
13 his own independent misleading statements in furtherance of
14 such a scheme to defraud that was the basis for the original
15 motion.

16 MR. SMITH: Your Honor, I would respectfully disagree
17 with that statement. As I stated in our original memorandum of
18 law, while they do make certain individual allegations against
19 O'Connor, the tone of their entire opposition or, I'm sorry,
20 amended complaint is this scheme, this collusion among all of
21 the defendants.

22 THE COURT: Because that is the nature of this claim.
23 This claim isn't about separate individual conduct in
24 furtherance of the scheme. That's not the claim. The claim is
25 the scheme.

1 MR. SMITH: OK. But by that --

2 THE COURT: More than one person could be primarily
3 involved in the scheme and take acts in furtherance of the
4 scheme. If you say Optionable put out a false statement in
5 furtherance of the scheme on Monday and Mr. O'Connor put out a
6 separate statement in furtherance of the scheme on Tuesday, how
7 is it that both are not primary violators?

8 MR. SMITH: I don't think that is what happened here.

9 THE COURT: They partially say that he made certain
10 representations in terms of the relationships of companies and
11 he adopted other statements that were publicly made in which he
12 personally was involved in making certain representations.

13 MR. SMITH: If that's the case --

14 THE COURT: Isn't that what we discussed the last time
15 we went through the motion?

16 MR. SMITH: I was not here for the last motion.

17 THE COURT: You don't get to hide behind that.

18 MR. SMITH: No, I completely understand that, and I'm
19 not intending to. I would add that if that is the case and
20 that is the Court's view, then he can't be found liable as a
21 control person.

22 THE COURT: That's what I'm trying to find out. I'm
23 trying to key up the issue in terms of where we are today given
24 the status of the case. I'm not sure what you're arguing. I
25 understand your argument about primary violator and that the

1 evidence doesn't support that Mr. O'Connor is a primary
2 violator. The problem is we have already been through that
3 argument and it has already been determined that at least the
4 factual allegations that were made specifically regarding Mr.
5 O'Connor and the acts that he was engaged in and certain
6 representations that he made minimally met the pleading
7 standard for the SEC to move forward against Mr. O'Connor.

8 With regard to the primary violation, it seems to me
9 that it is not an appropriate argument at this point to simply
10 argue again that it fails to state a cause of action. If it's
11 already been ruled that the allegations that it also included
12 in this complaint stated a cause of action against him, we are
13 not to revisit that. The real question is what's different
14 about this amended complaint that you say is not sustainable.

15 What I understand you saying is different and not
16 sustainable is the fact that they have added a claim for
17 control person. So isn't the only question then, since they
18 already have what has been determined to be a minimally
19 sufficient set of allegations to state a primary claim against
20 Mr. O'Connor, can they now on top of that and at the same time
21 amend to allege also control person liability, particularly in
22 light of Optionable's admissions since the original complaint?
23 Is that an inaccurate way to characterize where we are?

24 MR. SMITH: No, your Honor, I agree that is exactly
25 where we are. I would just add and submit that the adding of

Optionable and Optionable's settling of the claims against it do have an effect on your Honor's prior holding that the 10b-5 claims against Mr. O'Connor, in light of what I have just argued.

THE COURT: Why would it have any other effect than ultimately determining that they cannot recover on both theories at the end of the day? They have to recover on one or the other as alternative theories if they are basing it -- quite frankly, I think it is broader than both parties have argued. It is not a question of whether they are basing it on the same conduct. It is really a question of whether they are basing it on the same scheme to defraud.

If I have a scheme to defraud and I'm directing five different people to make false representations and doing acts in furtherance of that scheme, that is not five different schemes. As a matter of fact, I think the SEC, if I remember correctly, conceded in their opposition to the motion to dismiss the primary claim in the first complaint that --

Let me see if I have a reference in my decision. I had to look at this complaint to see if it is different. I don't think it is. They say they were confined and proceeding under sections (a) and (c) of 10b-5 and not subsection (b), and therefore they are not focused on the individual conduct in furtherance of the scheme, they are focused on the scheme.

I think they will have to concede when they get up, if

1 that is how they intend to proceed and that's the way this
2 complaint continues to read, that there is no way they can
3 prove more than one scheme. This is one scheme. They rely on
4 exactly the same MO and exactly the same results that both
5 Optionable and O'Connor, by their allegation, is involved in.

6 It is clearly not that Optionable is involved in one
7 scheme and O'Connor is alleged to be involved in a different
8 scheme. In the abstract I agree with you that it doesn't
9 appear that the facts based on those allegations could support
10 separate primary liability and control person liability at the
11 same time. That's like saying I'm an aider and abettor and a
12 co-conspirator. Well, you're one or the other. You can in the
13 abstract say that you are both. The acts that you commit being
14 one might be the same acts you commit being the other. But
15 they are not two different bases for independent liability at
16 the same time.

17 If I'm a co-conspirator, then I have primary
18 liability, and I don't have a separate claim for some other
19 liability. If he is a primary participant in this scheme,
20 wouldn't that make him liable on that basis, and if it turns
21 out that he is simply a control person and the acts that he is
22 taking in furtherance of the scheme are being conducted through
23 the company, if that's what they are relying upon, that would
24 be control person liability.

25 MR. SMITH: To your Honor's point, if this is one

1 grand scheme, I would argue that there can only be one primary
2 violator of this one scheme.

3 THE COURT: If there are two people involved in one
4 scheme, why can only one of them --

5 MR. SMITH: Isn't that the meaning of "primary," that
6 there is one, that Optionable is the primary violator of this
7 scheme? How can Optionable or Lee or O'Connor or anyone else
8 be a primary violator of this one scheme? If there were two
9 schemes, maybe that would be a different argument.

10 THE COURT: It depends. There is a way to do that.
11 Control person liability is that I am executing my scheme
12 through you by directing you to do things in furtherance of my
13 scheme.

14 Primary liability would be it's both our scheme. We
15 are sitting down and we both agree that this is what we are
16 going to do. You're going to take certain independent actions
17 in furtherance of this scheme, A through C, I'm going to take
18 other independent action in furtherance of this scheme, D
19 through F, and we both intend that we are going to primarily do
20 whatever it takes to make this scheme work regardless of
21 whether or not what the other person does is affected. That
22 doesn't make me a control person. Not in this context but in a
23 real sense it makes us co-equal co-conspirators who are acting
24 together to obtain a result for themselves.

25 It is awkward for me to think on these set of facts as

1 alleged how it is -- quite frankly, I'm not sure if any
2 individual on these facts is found to be a primary actor, has
3 primary liability. And it is based solely on the acts that
4 they directed through Optionable, and Optionable doesn't have
5 other, independent acts that make it independently liable.

6 if Mr. O'Connor is alleged to have directed all of his
7 scheme through his control of Optionable, I'm not sure in what
8 way you're going to prove that Optionable is making independent
9 decisions based on its own effort to further the scheme on its
10 behalf, if it's just carrying out Mr. O'Connor's scheme. It
11 sort of depends on who else is in the scheme and who is
12 considered, quote, to be Optionable.

13 If the acts taken by Optionable are simply at the
14 direction of Mr. O'Connor, if they can prove that, it seems to
15 me that regardless of whether or not Optionable admits to being
16 a primary -- the fact that Optionable admits to being a primary
17 actor here, I don't know any case law that says that that would
18 preclude proving that someone else controlled them and is still
19 independent.

20 MR. SMITH: No, it doesn't preclude that someone else
21 controlled them. What I would argue is that if someone
22 controlled them, they can't also be in concert with them or be
23 a primary violator alongside with them. That would be my
24 argument, and I don't think the facts here support that
25 finding.

1 THE COURT: You want me to make that conclusion simply
2 based on their admission that they were a participant in a
3 scheme. You're saying unless their admission included a
4 statement that they were being directed by a control person,
5 that somehow it precludes somebody else being found to have
6 controlled them. I could plead guilty to bank robbery, and
7 they can still independently prove that you are the one that
8 paid me to go rob a bank. It doesn't preclude that they would
9 admit a primary violation. It doesn't preclude a factual
10 scenario that would independently demonstrate that O'Connor was
11 the primary actor rather than Optionable.

12 You also have the context of we're talking about a
13 corporate fiction here. You're not talking about Mr. Smith
14 saying, I was the primary violator, and now they want to say
15 Mr. O'Connor was the primary violator. I'm not sure I know of
16 any case law that says because the corporation decides to plead
17 guilty to liability, to being involved in a scheme, that that
18 precludes the possibility that the individuals who act or
19 direct corporate officers or others in the corporation, that
20 that precludes finding primary liability with regard to those
21 individuals.

22 MR. SMITH: That is because there is no case law, your
23 Honor.

24 THE COURT: Right. But that makes sense, though.

25 MR. SMITH: It is an issue for the Court.

1 THE COURT: A corporation doesn't have arms and legs
2 and a corporation doesn't make statements. People do so on the
3 corporation's behalf, and other people direct individuals to do
4 so on behalf of the corporation. So there is no real conflict
5 between a corporation being primarily liable and an individual
6 being held to be liable as the control person, is there?

7 MR. SMITH: I'm sorry, your Honor?

8 THE COURT: I said there is no inconsistency with a
9 corporation being determined to be primarily liable and a
10 person who is determined to be a control person also being
11 determined to be primarily liable.

12 MR. SMITH: No, but I would argue that there cannot be
13 two primary violators.

14 THE COURT: I understand that argument in the abstract
15 with regard to --

16 MR. SMITH: Ultimately, we know that O'Connor cannot
17 be found liable for both.

18 THE COURT: Right, but that's different.

19 MR. SMITH: I understand.

20 THE COURT: Those are different arguments. I don't
21 think I can accept the premise that there can't be two primary
22 violators. In many cases there's more than one primary
23 violator. There are co-defendants all the time who are found
24 to have violated 10b-5.

25 MR. SMITH: There is no case law that I could find,

1 and I'm sure that the SEC could not find as well, that
2 expressly states that, though, that there can be two primary
3 violators. I would argue that the Janus Capital case goes
4 against that.

5 THE COURT: It doesn't say that. Doesn't it say that
6 there can't be a primary violator and someone else who is both
7 a control person violator and a primary violator?

8 MR. SMITH: It says that you cannot bring an aider and
9 abettor under 10b-5 with the primary violator.

10 THE COURT: Right. But that's a different issue.
11 This isn't an aiding and abetting claim. This isn't that
12 Optionable helped Mr. O'Connor or Mr. O'Connor helped
13 Optionable. It's a claim that Mr. O'Connor, through the use of
14 the corporation, controlled and directed and allowed the
15 corporation to take acts in furtherance of the scheme that he
16 was primarily involved in.

17 MR. SMITH: That's a 20(a) claim, not a 10b-5 claim or
18 10(b) claim. If he used the corporation, controlled the
19 corporation, then that would be control person liability claim,
20 not that he is the primary violator.

21 THE COURT: To the extent that you are relying on
22 actions in furtherance of that scheme that are not his
23 individual actions. To the extent that they say he
24 individually made misstatements to further the scheme, he is a
25 primary violator, isn't he? That's the definition of the

1 claim, right?

2 If he went out and said, put this false statement in
3 the report, or he went out and made a public representation
4 himself or he hid some information that he knew that he was
5 directly asked about and should have disclosed, regardless of
6 what the corporation did, that would make him primarily liable
7 under 10(b), wouldn't it?

8 MR. SMITH: Your Honor, I respectfully disagree. If
9 it was part of what you stated earlier, that this is broader
10 than what the SEC, and we argue that it fit one giant scheme --

11 THE COURT: Whose scheme is it? That's the question.

12 MR. SMITH: It's Optionable's scheme. They consented.

13 THE COURT: That's the point. Optionable can't have a
14 scheme. Somebody at Optionable comes up with a scheme.
15 Optionable is a corporation.

16 MR. SMITH: Correct.

17 THE COURT: The question is, what individual is
18 primarily responsible for the scheme and what acts did that
19 individual take to utilize the corporation and corporate
20 representatives to further that scheme? That's why to say
21 Optionable is primarily liable for the scheme, well, quite
22 frankly, technically, whether they had control person liability
23 or not, Optionable didn't make up the scheme. Somebody at
24 Optionable made up the scheme. That person is clearly
25 primarily liable, right?

1 MR. SMITH: Then what was the purpose of adding
2 Optionable to the amended complaint?

3 THE COURT: Because Optionable under such a theory
4 would still have corporate liability, right?

5 MR. SMITH: Right.

6 THE COURT: They are not excused from the acts from
7 which the corporation benefited. The theory is that you don't
8 benefit those who have an interest in the corporation by
9 letting them use the corporate form to say, I didn't personally
10 make money, it all went into my corporation. That's the reason
11 for that.

12 A corporation doesn't go to jail. The corporation has
13 to say, OK, these profits don't belong to the corporation, they
14 belong to someone else because they are ill-gotten gain. If
15 the corporation admits that it was utilized by individuals to
16 generate that ill-gotten gain, then the corporation clearly has
17 minimal civil liability for that. And that is independent of
18 whether or not any other people who acted on behalf of the
19 corporation or directed people in the corporation to further
20 the scheme.

21 That is why I don't see inconsistency with Optionable.
22 Optionable, as they say, laid down and played dead, said OK,
23 you got me, I'm done, let's put this behind us, whatever
24 penalties you want, and we'll go, do what you will with the
25 people who made us do it.

1 MR. SMITH: I understand what your Honor is saying. I
2 would submit that the SEC added Optionable in order to fill
3 that slot of the primary violate and also be able to bring a
4 control person liability claim against Mr. O'Connor, and that
5 primary violator slot has been filled with Optionable.

6 THE COURT: The inconsistency on that argument is that
7 they had already withstood a motion to dismiss the primary
8 claim against your client.

9 MR. SMITH: That was before Optionable was added as a
10 party.

11 THE COURT: That's what I'm saying. They didn't add
12 Optionable so that they could add a claim against your client.
13 They already had a sustainable claim against your client.
14 Whether they will be able to prove it is a different case.

15 MR. SMITH: Believe me, it is a mystery to me why they
16 added Optionable and a control person liability claim when they
17 already had a 10b-5 claim against our client that was
18 sustained. But I will leave that up to the SEC.

19 THE COURT: Let me let them explain that, and then
20 I'll let you reply.

21 What is supposed to be different now than what existed
22 prior to the amended complaint?

23 MR. WALFISH: I'm happy to answer that. May I use the
24 podium, your Honor?

25 THE COURT: Sure. Tell me what your theory is. Let

me start out before you begin. Are you pursuing these as alternative claims or are you pursuing these as independent claims that you believe can both be sustained at the same time?

MR. WALFISH: I'm sorry, what are the "these"? The primary claim against Mr. O'Connor and the control person claim against Mr. O'Connor?

THE COURT: Yes.

MR. WALFISH: Yes.

THE COURT: Yes what?

MR. WALFISH: Yes, I understand your question, and I'm about to answer it. Ultimately, when a jury returns its findings, there is case law to suggest that someone cannot, for the exact same conduct, for the same set of facts, be liable both as a primary violator and as a control person.

THE COURT: So we have an understanding.

MR. WALFISH: We understand that principle. But what is going on here in our amended complaint is something far different. For one thing, the conduct that is alleged against Optionable the entity is far broader than the conduct alleged individually against Mr. O'Connor.

THE COURT: But not the conduct that constitutes the offense. I thought that you went out of your way with regard to the original complaint to say that this is under (a) and (c) and not (b).

MR. WALFISH: Yes, your Honor. The portion of the

1 decision that your Honor read from was specifically addressed
2 to what was called at the time, quote, the fraudulent scheme
3 claim. That was Count One of the SEC's complaint. But Count
4 Two of the SEC's complaint was specifically for misstatements
5 and omissions that the various defendants committed. The
6 opinion goes on to acknowledge that.

7 We clarified then at the time that we were proceeding
8 under Rule 10b-5(b) with respect to Count Two, charging both
9 Mr. O'Connor and his colleagues at Optionable the company with
10 making misrepresentations and material omissions to investors.

11 So, in the amended complaint what we are saying is
12 because, as your Honor said, companies can only act through
13 human beings, the company Optionable is responsible for the
14 acts, the omissions, and the statements of all of its officers
15 and agents. That includes Mr. O'Connor and it includes other
16 people, too, including Kevin Cassidy of Optionable.

17 THE COURT: It is unclear to me how you define the
18 separate conduct that makes Mr. O'Connor primarily liable
19 independently of Optionable and makes Optionable primarily
20 liable for something different.

21 MR. WALFISH: Your Honor, to the extent that, for
22 example, Kevin Cassidy made statements to investors, that he
23 personally made statements, it might be that for certain of
24 those statements Mr. O'Connor is not individually liable for
25 his own section 10(b)/rule 10b-5 violation. However, the

1 company Optionable surely would be primarily liable for the
2 statements that another one of its officers makes.

3 THE COURT: Your amended complaint doesn't allege
4 those as separate claims.

5 MR. WALFISH: Judge, respectfully, I think we are
6 quite clear in the amended complaint that we are alleging that
7 Mr. O'Connor as a control person of Optionable is liable for
8 everything that the company did.

9 THE COURT: But that is a different question. That is
10 not the question. The way you describe it, that would make it
11 separate claims, right?

12 MR. WALFISH: I'm sorry, your Honor, I don't agree
13 with that. I think we are only required in the complaint to
14 particularize statements, omissions, fraudulent acts, and so
15 forth. Then, at the end of the complaint, in the charging
16 section, we can say there is a claim for relief here, these
17 people made statements and omissions as alleged. We have
18 particularized the statements that Mr. O'Connor made and that
19 others at Optionable made.

20 THE COURT: But you don't separate it the way you're
21 trying to argue it here.

22 MR. WALFISH: We did.

23 THE COURT: You don't separate that. You don't say
24 that they are two schemes. You don't say that certain
25 defendants are liable for certain conduct that other defendants

1 aren't liable for. That's the way you're arguing it, but
2 that's not the way you have alleged it. You have alleged that
3 they are involved in the same scheme and are primarily and as
4 control persons liable for the fraudulent conduct. You don't
5 say that this defendant is liable for conduct A and defendant B
6 is liable for conduct B.

7 MR. WALFISH: Your Honor, I don't think that is a fair
8 reading of the complaint at all. If I could direct your
9 attention.

10 THE COURT: Show me where you have separate conduct
11 that represents separate claims in your amend complaint.

12 MR. WALFISH: I'll point your Honor to separate
13 conduct.

14 THE COURT: No, separate conduct that is alleged as
15 separate claims.

16 MR. WALFISH: Your Honor, I think the cases are clear
17 we don't need to say this is a separate claim in the sense of
18 causes of action. We say that we have a section 10(b)/Rule
19 10b-5 claim against Mr. O'Connor, against Kevin Cassidy,
20 against Optionable the company.

21 THE COURT: The same claim or a different claim?

22 MR. WALFISH: Your Honor, the word "claim," I think
23 there is a lot of elasticity in it.

24 THE COURT: There is no elasticity for a jury. For a
25 jury I'm supposed to say these are the elements, you have to

1 find these elements as to this defendant and you have to find
2 these elements as to this defendant; if you find Mr. Cassidy
3 did X but Mr. O'Connor wasn't involved in X, then you can only
4 use that to find a claim against Mr. Casky; if you find that
5 Mr. O'Connor did Y and Mr. Cassidy didn't do Y, then you can
6 only use that against Mr. O'Connor.

7 MR. WALFISH: That's right.

8 THE COURT: That is true with regard to the control
9 person liability also. You want to splice it as claims at the
10 same time rather than alternate claims to say that a jury can
11 find that Mr. O'Connor is liable as a primary violator for X
12 conduct but liable only as a control person violator for Y
13 conduct, but that's not the way you lay it out in the
14 complaint.

15 MR. WALFISH: Your Honor, we don't have to.

16 THE COURT: You do.

17 MR. WALFISH: No, we don't.

18 THE COURT: If you say that there are alternative,
19 independent theories of liability, you must allege it in a way
20 that they can independently be proven regardless of whether the
21 other case is proven. You don't do that. You want to get the
22 benefit of lumping it all together, but then you say you want
23 the benefit of being able to ask the jury to find that even if
24 you find that we haven't proven he is primarily liable for this
25 conduct, we have proven that somebody else is liable for this

1 conduct and we have proven that he is a control person. No, I
2 take that back.

3 What you want to do is you want to say that you can
4 get a jury verdict that Mr. O'Connor is both primarily liable
5 and liable as a control person.

6 MR. WALFISH: For different conduct.

7 THE COURT: That's what I'm trying to understand.
8 Where in the complaint? Show me in the complaint where I can
9 read that and find that.

10 MR. WALFISH: Judge, respectfully, I think the
11 complaint doesn't need to splice it in the way that you are
12 describing. This complaint, the way that we have let it out,
13 the way we have labeled things, alleged things, the way that we
14 have incorporated them by reference, to my knowledge, is a
15 completely standard way of pleading first primary liability and
16 then control person liability. I'm not aware of any cases in
17 which claims have been dismissed because of this type of
18 labeling.

19 THE COURT: Those cases primarily deal with
20 alternative pleading, alternative pleading. That's why my very
21 first question was whether or not you are strictly arguing that
22 you should be able to say to the jury that you can prove that
23 he was either a control person or he was primarily liable, or
24 are you arguing that you should be able to say to the jury, we
25 want you to give us a determination that he is both primarily

1 liable and liable as a control person, and if that is your
2 theory, what is the different conduct that you lay out in this
3 complaint that would make them understand on what theory is he
4 independently liable for one but not liable for the other? No,
5 I have to take that back. On what theory is he independently
6 liable for both at the same time as separate theories of
7 liability?

8 MR. WALFISH: There are many different ways that could
9 be true. For example, it might be that he is personally liable
10 only for certain statements that he has made but he is liable
11 as a control person for this U-turn quotation scheme. Remember
12 that we have both statements to investors and we have the
13 quotation scheme.

14 THE COURT: But that's alternative pleading.

15 MR. WALFISH: No, your Honor, absolutely not.

16 THE COURT: You're saying that you believe, based on
17 the way you have alleged it in this complaint, that you could
18 come back with two findings, one that he is liable as a control
19 person and he is also primarily liable?

20 MR. WALFISH: Your Honor, I'm saying that we have
21 alleged lots of different --

22 THE COURT: Answer that question first. Are you
23 saying that you can ask a jury to render a verdict that he is
24 both liable as a control person independently based on
25 independent conduct and liable as a primarily liable?

1 MR. WALFISH: Yes, absolutely, the jury can find that,
2 yes.

3 THE COURT: What are the separate facts that support
4 his control person liability and what are the separate facts
5 that would support his primary liability?

6 MR. WALFISH: Your Honor, I can give some examples of
7 how that might play out.

8 THE COURT: I'd like you to point me in the complaint.

9 MR. WALFISH: I will in a moment, but I really want to
10 add something before I direct your attention to some specific
11 portion of the complaint. It would be up to the jury to decide
12 which facts support primarily liability against this actor or
13 that actor and which facts support control person liability
14 against this actor or that actor, recognizing that if the
15 conduct is precisely congruent, exactly the same, then it is
16 possibly true that someone could be held on both theories.

17 THE COURT: No, it is not up to the jury. It is up to
18 you to allege it. The jury can't figure that out unless you
19 have alleged it. They can defend against it unless you have
20 alleged it.

21 MR. WALFISH: This complaint, your Honor, I think is
22 pretty standard.

23 THE COURT: The standard as an alternative theory of
24 liability, I'm trying to understand in what way you say that he
25 on the one hand has control person liability and on the other

1 hand, for other, different conduct, he has --

2 MR. WALFISH: I'm trying to explain that. I'm trying
3 to explain that.

4 The complaint alleges, and I can direct you as an
5 example by way of illustration to paragraphs 50 and 51, just as
6 an example. The complaint alleges statements that Kevin
7 Cassidy made that Edward O'Connor did not make. Those
8 statements by Kevin Cassidy are manifestly also the statements
9 of Optionable the company.

10 Mr. Smith mentioned the Janus Capital decision, which
11 he didn't cite in any of its papers even though it is a U.S.
12 Supreme Court case decided last year. He also completely
13 mischaracterized its holding. But if Janus stands for
14 anything, it is not that there is no such thing as aiding and
15 abetting liability, it is that under Rule 10b-5(b) the maker of
16 a statement is the person who actually utters it rather than
17 other people who are involved. If Janus stands for anything,
18 it is that.

19 Now, it might be that under that principle or another
20 one, Mr. O'Connor sitting there on this phonecall potentially
21 is not primarily liable for statements that Kevin Cassidy is
22 making to investors. But Edward O'Connor was surely a control
23 person of Optionable and as such would be liable for statements
24 that the company is making acting through Kevin Cassidy. That
25 is an example of conduct for which he would be liable as a

1 control person but not primarily.

2 THE COURT: That's what I'm trying to understand. Is
3 your theory that you can get a judgment as to both control
4 person and primary liability? Is the difference between those
5 theories that this complaint is to be read that your claim for
6 primary liability has to do with statements that were made by
7 Mr. O'Connor personally and your theory for control person
8 liability has to do with statements that were made by others
9 and not made by Mr. O'Connor?

10 MR. WALFISH: Right. That's how it would play out on
11 a full presentation to the jury and proper jury instructions.

12 THE COURT: Is there any other theory of simultaneous
13 liability other than you're saying that this amended complaint
14 supports a theory of primary liability for statements and
15 omissions made directly by Mr. O'Connor and control person
16 liability for statements made by Cassidy and others that were
17 made with Mr. O'Connor's knowledge or at his direction?

18 MR. WALFISH: Yes.

19 THE COURT: Any other theory?

20 MR. WALFISH: Yes. I'm saying yes, we have other
21 theories.

22 THE COURT: What is the other theory? Other theory of
23 what? Other theory of control person liability or other theory
24 of primary?

25 MR. WALFISH: Both, your Honor. Please give me a

1 chance to elaborate. I think I can answer your question.
2 You're asking, apart from people like Kevin Cassidy making
3 misstatements and holding Mr. O'Connor liable as a control
4 person versus as a primary violator, any other facts, any other
5 theory that would support both types of liability. The answer
6 is yes.

7 With respect to this quotation scheme, we allege that
8 Scott Connor and Kevin Cassidy are essentially recycling
9 quotations that came from David Lee at Bank of Montreal and
10 recycling them to the people of Bank of Montreal supposed to be
11 checking David Lee's quotations. We also allege that Edward
12 O'Connor did that. It is entirely possible that Edward
13 O'Connor is primarily liable to the extent that he is
14 personally doing that and that he is liable as a control person
15 to the extent that Optionable is doing that acting through
16 Scott Connor and Kevin Cassidy. That is claim one.

17 THE COURT: Do you allege that he personally did that?

18 MR. WALFISH: Yes. I can point you to the exact
19 paragraph, if you wish.

20 THE COURT: Yes, that would help.

21 MR. WALFISH: Paragraph 32 of amended complaint which
22 was submitted as Exhibit A to our declaration.

23 THE COURT: I have it. Paragraph 32.

24 MR. WALFISH: Yes, page 14. Paragraph 32 says Mr.
25 O'Connor directly handled this process, personally receiving

1 information and sending it. It also says he is reviewing and
2 approving other people's work, reassuring them when they
3 express discomfort, telling them where to send the information.
4 This can clearly support primary liability for Mr. O'Connor and
5 control person liability to the extent that it is the company.

6 THE COURT: That's the part I don't understand. If he
7 is primarily liable for directing someone to make a
8 misstatement --

9 MR. WALFISH: I didn't say that he is. He might be,
10 but I didn't say he was.

11 THE COURT: What is it you're saying he is primarily
12 liable for?

13 MR. WALFISH: He is primarily liable to the extent
14 that he personally did something. And that could include, by
15 the way, aiding and abetting. Even though we are using the
16 word "primary" here, that includes holding him liable under
17 10(b) for aiding and abetting, which is alive and well in the
18 SEC charges even after Janus.

19 THE COURT: Aiding and abetting, that is just
20 semantics. The question is whether he is doing the acts
21 personally.

22 MR. WALFISH: Right.

23 THE COURT: Doing the acts through others who are
24 doing it at his direction or whether or not he is helping
25 someone else carry out their independent scheme, legally there

1 is no distinction to be made. The only legal distinction to be
2 made is whether or not he is a control person or whether or not
3 he is primarily an actor. If he is an aider and abettor, not a
4 control person, he is primarily an actor, isn't he?

5 MR. WALFISH: I think that's right.

6 THE COURT: There is no such thing as had some lesser
7 degree or different degree of participation, or there is no
8 lesser or different degree of participation or liability to be
9 made between someone who you want to characterize as a primary
10 actor or someone you want to characterize as an aider and
11 abettor?

12 MR. WALFISH: I agree with that, your Honor. When I
13 say "primary," I'm referring to both of those. But control
14 person is a slightly lesser standard of involvement. There are
15 three. There is the I personally do something, I aid and abet
16 someone else, or I'm liable as a control person of let's say a
17 company who does something. We have alleged all three. We
18 don't have to choose right now which it is, and we can take
19 full discovery and then let the jury decide the theories.

20 THE COURT: I'm trying to get a real understanding
21 other than you have a menu of stuff that you want the jury to
22 be able to decide. I'm trying to figure out what it is you
23 claim happened and what it is you claim that you are going to
24 prove. You are still a little vague as to Mr. O'Connor,
25 regardless of any evidence with regard to control person,

1 whether you have independent evidence and made independent
2 sufficient allegations that he himself is a primary violator
3 regardless of the issue of control person.

4 MR. WALFISH: I don't agree with that, your Honor.
5 The Court has already determined that the initial complaint,
6 which, as your Honor knows, contained less, not more,
7 information than the current complaint, that that initial
8 complaint adequately alleged primary violations against Mr.
9 O'Connor.

10 THE COURT: That begs the question that has already
11 been raised. What is the point now at this late stage adding a
12 control person liability? What kind of theory? As an
13 additional thing you want to prove or as alternative things you
14 want to prove?

15 MR. WALFISH: It is as to the same facts an
16 alternative theory of liability, and it is also an additional
17 theory of liability. It is a lesser standard than the aiding
18 and abetting.

19 THE COURT: I'm not sure I agree with the way you're
20 characterizing it. It's a different standard but it is not a
21 lesser standard.

22 MR. WALFISH: OK. I might have to respectfully
23 disagree with your Honor's characterization.

24 THE COURT: If you find somewhere any case that says
25 control liability is a lesser standard, I'd be shocked and

1 surprised. I think that is the word you chose. I don't think
2 any case anywhere in the United States refers to control person
3 liability as a, quote, lesser standard. It is a different
4 standard.

5 MR. WALFISH: The elements I think are easier to
6 satisfy than for aiding and abetting.

7 THE COURT: It depends on your facts. It is not
8 necessarily easier. It may be easier in this case. As a
9 matter of fact, you're arguing just the opposite. It is
10 probably easier for you to prove the primary liability than it
11 is to prove the control person liability because for control
12 person liability all you have to do is identify the false
13 statements he made in furtherance of the scheme. As to control
14 person liability, you have to identify exactly in what way he
15 was a control person and in what way he had culpable
16 participation. I'm not sure that that is necessarily any
17 easier or harder. It depends on your facts.

18 MR. WALFISH: Your Honor, I think at the pleading
19 stage I think we don't have to do quite as much as Mr. Smith
20 would have it. If we allege that he was the senior officer at
21 the company, that he knew what was going on, that he was
22 culpably involved in it, that is enough to satisfy the
23 statutory requirements.

24 THE COURT: It is not typically enough to say that he
25 was an officer of the company so he must have known what was

1 going on.

2 MR. WALFISH: I respectfully disagree with that. I
3 think the cases are quite clear that if someone was the CEO as
4 in this case, the CEO of the company, that satisfies the
5 requirement of control. Although, if someone is senior enough
6 at the company to sign its SEC filings, that, too, is a basis
7 from which to infer control. I think the cases are very clear.
8 We tried to cite a slew of them in our papers.

9 THE COURT: The cases are clear with regard to what
10 factors you can consider to decide whether or not there is a
11 reasonable inference of control. But the cases don't stand for
12 the proposition that simply because you're a CEO, that
13 necessarily means that you have control.

14 MR. WALFISH: Your Honor, I'm not sure that I agree.
15 I can read to you from cases in this district that essentially
16 say that. I have them right there at the table, if your Honor
17 wishes. I don't know if this is what you want me to get into,
18 but I don't agree with your statement, respectfully.

19 THE COURT: What do you do with the case law that
20 clearly says that a person's status alone is not necessarily
21 sufficient to allege control?

22 MR. WALFISH: That is an absolute, in my opinion, from
23 Mr. Smith total mischaracterization of what those cases say.
24 What they say is, quote, officer or director -- this is just
25 language, not holding -- officer or director status is not

1 enough.

2 THE COURT: Right.

3 MR. WALFISH: Please let me explain. If you look
4 closely, every one of the cases that actually dismisses control
5 person liability on the basis of a pronouncement like that is
6 dealing with an outside director, that is to say, someone who
7 has a seat on the board of directors but no role in the day-to-
8 day management of the company, no idea what is actually going
9 on at the company, sitting in a passive role where a few times
10 a year they take part in board of directors meetings.

11 By contrast, there are cases that specifically say,
12 oh, yeah, we were a little bit too loose when we said officer
13 or director status is not enough, because if you are the CEO of
14 a company, that is enough to infer control. Like I said, I can
15 read specifically, although we cite them in our brief, cases
16 where judges from this district say plaintiff alleged that this
17 person had a senior role, that is enough of a basis from which
18 to conclude that that person had policy-making power at the
19 company. I can offer those cites if your Honor wishes.

20 THE COURT: I think you have them cited in your brief.

21 MR. WALFISH: I do, yes.

22 There are other issues I'd like to cover, unless your
23 Honor has anything further.

24 THE COURT: No, go ahead.

25 MR. WALFISH: Thank you. The settlement with

Optionable formally is not an admission of liability. By the plain terms of the consent that Optionable signed, they are not admitting or denying liability. I understand that there is a perception that somebody only settles one of these things because they think that they are guilty somehow. That's fine.

But if Mr. Smith is right that merely settling is an admission of liability that furthermore displaces the possibility that anybody else is a primary violator, then Scott Connor's consent in this action a few years ago would have prevented Mr. O'Connor and Kevin Cassidy from being primary violators. So, too, would David Lee's consent earlier, again a few years ago, displaced the possibility that Kevin Cassidy, currently in jail for fraud on these allegations, was a primary violator. That surely is not the law.

If I could check my notes and see if I have any other points that I wanted to cover?

THE COURT: OK.

MR. WALFISH: Your Honor, Mr. Smith mentions Mr. O'Connor's recent deposition testimony. I hope the Court will appreciate that under the Federal Rules of Civil Procedure that is simply not a proper subject of consideration here. It is clear that if that testimony is in any way considered, then we get a chance to make a full evidentiary submission, because the motion would have been automatically converted to one for summary judgment.

1 Even setting all those points aside, though, if one
2 looks closely at that deposition, I think from it alone, let
3 alone what we have gotten and will continue to get from other
4 witnesses, it actually would allow a fact-finder to conclude
5 that this person is quite culpable on a number of different
6 theories.

7 I think that is pretty much all that I have. Unless
8 the Court has further questions.

9 THE COURT: No. Thank you.

10 MR. WALFISH: Thank you.

11 THE COURT: Mr. Smith, did you want to reply?

12 MR. SMITH: I want to add that to the issue of whether
13 or not control is on the basis of status alone, we cited case
14 law that stands for just the opposite of what the SEC has
15 stated in its opposition from this court where just being a CFO
16 or CEO alone does not rise to the level of control. There's
17 got to be something in addition to that.

18 THE COURT: It seems to me that the control issue
19 isn't the determinative issue. The determinative issue is what
20 was the mental state of the defendant. To the extent that the
21 complaint alleges that certain conduct was engaged in
22 consistent with the scheme, whether he is a control person or
23 not doesn't prove the case. You could be a control person, and
24 it doesn't make you liable, give you all of the elements of
25 control liability.

1 You also have to be able to demonstrate, and more
2 importantly demonstrate, that it is reasonable to infer that
3 the acts of the corporation were taken in furtherance of the
4 scheme that has to be independently proven by the plaintiff.
5 Just because Bill Gates is the control person of Microsoft
6 doesn't mean that the guy who is stealing paperclips on the
7 fifth floor is under his control with regard to the illegal
8 activity that he may be involved in.

9 I don't think most cases address it this way, but in
10 most cases it is not an issue, because what is more
11 determinative is whether or not there is an inference that the
12 acts are being taken by the corporation that constitute a
13 violation that is clearly being done at the behest of the
14 plaintiff or with the plaintiff recklessly disregarding the
15 possibility that that is going on. That is the determinative
16 issue rather than whether or not the person is the boss.

17 MR. SMITH: That's correct, your Honor.

18 THE COURT: We know he's the boss. That doesn't mean
19 that the control liability is whether or not there is an
20 inference that he is controlling the activity that is at issue
21 here.

22 MR. SMITH: That's correct, your Honor. I would
23 submit, and we set forth in our motion papers, that it does not
24 rise to that level, that the SEC has failed to prove or allege
25 facts that would be sufficient to allege culpable

1 participation.

2 THE COURT: It's awkward to try to do that
3 independently in most cases. If you take their allegation that
4 he was both personally involved in and was aware of the
5 activities of others with regard to the U-turn activity and
6 that it is reasonable to infer that those people who were
7 involved in that activity knew that that was fraudulent
8 activity, there is not a whole bunch of question about whether
9 or not, if in fact they can prove that he did that and did that
10 in his capacity as a CEO, you would have to prove a whole lot
11 more to prove that he is a control person.

12 MR. SMITH: Right.

13 THE COURT: If he knows what Cassidy is doing and he
14 is directing or acquiescing in what Cassidy is doing or it can
15 be inferred that other people in the company are doing things
16 on his behalf, this scheme that they have independently proven,
17 then I don't think that the determinative issue is whether or
18 not there is enough evidence as a control person. They usually
19 go hand in hand.

20 The only other thing I'll give you a chance to
21 address, you raised the Optionable settlement at first. They
22 validly point out, and I don't have the settlement agreement in
23 front of me, but they validly point out, I assume correctly so,
24 that the Optionable settlement does not include any admission
25 of liability.

1 How do you rely upon the mere settlement as somehow an
2 admission of liability that should have some preclusive effect?
3 I assume if your client decides to settle, under those terms
4 you're not going to allow anybody to say that that's an
5 admission that he was involved in certain misconduct if the
6 settlement specifically says it's not an admission.

7 MR. SMITH: That is an accurate statement, that in the
8 consent Optionable does not expressly admit to violating 10b-5.
9 It enjoins them, if I recall correctly -- I don't have the
10 consent in front of me -- from violating, and it lists a number
11 of sections.

12 THE COURT: It says don't do the things that you
13 shouldn't be doing in the first place.

14 MR. SMITH: It can be inferred. I would submit that
15 based on the amended complaint, in adding Optionable and adding
16 a control person liability claim against Mr. O'Connor, it is
17 clear to us, and that's why I am submitting to the Court that
18 in this settlement, in effect, Optionable is admitting to being
19 the primary violator under 10b-5.

20 THE COURT: They are not admitting to being any
21 violator.

22 MR. SMITH: Right, I understand that.

23 THE COURT: They are saying go away, what do you want.

24 MR. SMITH: That's why I say "in effect."

25 THE COURT: It's obvious that it is not an argument to

1 be made that that legally precludes them from proceeding
2 against any other defendant on any other theory because
3 Optionable decided that they wanted to get out.

4 MR. SMITH: I wouldn't necessarily use the word
5 "preclude." I would say that --

6 THE COURT: How does that make their complaint
7 insufficiently pled?

8 MR. SMITH: If they have sufficiently pled 10b-5
9 against Mr. O'Connor and, as they pointed out, this Court has
10 already denied our previous motion to dismiss based on the
11 primary liability claims against Mr. O'Connor, then I would, as
12 I do in our motion papers, say that their control liability
13 claims against Mr. O'Connor are insufficient and therefore
14 should be dismissed. The facts as alleged in the complaint do
15 not rise to a level of control. And even if it was determined
16 that the control element was satisfied, they haven't satisfied
17 the culpable participation element.

18 THE COURT: What do you say they need to allege
19 further in this case? Given his position, status, and holdings
20 and influence, what else do you say they need to allege to
21 allege that somebody is a control person?

22 MR. SMITH: I would submit that they haven't alleged
23 necessarily that he had dominion or control over certain
24 employees. They are hanging their hat on the fact that he
25 signed certain year-end statements or reports to the SEC,

1 10-KSBs.

2 THE COURT: That is not what they are primarily
3 hanging their hat on. They are primarily hanging their hat on
4 as the CEO he is the boss and he is in charge of all these
5 people. He tells them what to do, he fires them, he hires
6 them.

7 MR. SMITH: I would go back to what our position is,
8 that status alone does not translate into control, does not
9 equal control for purposes of 20(a), there's got to be
10 something more.

11 THE COURT: What more? That's what I'm trying to get
12 from you. He is the boss, he is in charge of everybody, he
13 knows about all of this activity, and he has not only delegated
14 those responsibilities with regard to the conduct at issue, he
15 is personally involved and knowledgeable at the conduct at
16 issue. Why wouldn't that be sufficient as a control person if
17 you are aware of and/or directing and/or participating in
18 furthering the conduct that they claim is the actionable
19 conduct?

20 MR. SMITH: If you are the CEO and you do have
21 dominion or control or power or possession over the acts of
22 certain employees, that would satisfy, or may satisfy I should
23 say, that one element of control. But you still have to
24 satisfy the culpable participation element.

25 THE COURT: We have been through the culpable

1 participation argument several times. That takes us back to
2 where we started. They originally alleged his culpable
3 participation sufficiently in the first complaint.

4 MR. SMITH: In the first complaint, though, there was
5 no control person liability.

6 THE COURT: But control person liability doesn't
7 define culpable participation.

8 MR. SMITH: I understand.

9 THE COURT: Either there was culpable participation on
10 any level or there wasn't. That's not the element that defines
11 whether you're a control person.

12 MR. SMITH: I understand, your Honor.

13 THE COURT: The element is what the nature and extent
14 of that direct or indirect culpable participation is.

15 MR. SMITH: I understand. To your Honor's point, the
16 SEC would be using the same facts that were alleged to
17 establish primary liability as satisfying the culpable
18 participation element as well.

19 THE COURT: There is nothing wrong with that. You
20 would need culpable participation whether you're a control
21 person or primarily liable. The same conduct that equals
22 culpable participation as a control person, at least one's
23 knowledge and mens rea, one's knowledge and understanding and
24 intent to further the scheme is exactly the same regardless of
25 whether you're a control person, not a primary person. The

1 mental state is the same.

2 And clearly the operative acts are whether or not you
3 are taking any steps to further that scheme, whether you're
4 taking steps to further that scheme by taking individual action
5 or by directing others or having others take action on your
6 behalf. That doesn't define the culpable participation. The
7 culpable participation is are you doing it with the
8 understanding that you are defrauding people. That's exactly
9 the same whether you are a control person or a primary.

10 MR. SMITH: I understand. I was just addressing your
11 Honor's earlier comments about distinguishing between are these
12 two theories based on the same set of facts or are there
13 different facts that support each individual theory. I was
14 just addressing that. I would still submit, your Honor, that
15 the facts as alleged do not rise to the level of culpable
16 participation.

17 THE COURT: Thank you.

18 Is there something you wanted to add?

19 MR. WALFISH: Just a very small point, your Honor.
20 You used the example of Microsoft and Bill Gates and the guy
21 maybe in the mailroom who is stealing paperclips. The only
22 thing I want to emphasize here is that Optionable is nothing
23 like that. This was a company with about 18 employees, all
24 working together in the same room. Essentially, Mr. O'Connor
25 knew what was going on at Optionable because he was working

1 alongside everybody all day long. That's all on that.

2 THE COURT: Are any of those facts alleged in this
3 complaint?

4 MR. WALFISH: The SEC filings of Optionable, which can
5 be considered on a motion addressed to the pleading, make that
6 clear. And we have citations to that SEC filing.

7 THE COURT: I remember you making that point, but I
8 couldn't remember whether or not that point was simply made in
9 your brief or whether or not there was a section in the
10 complaint that lays out that this is more akin to a small,
11 closely held company and that is what you alleged in the
12 complaint is a basis to find that. But at this point you're
13 saying that I should at least incorporate that by reference,
14 the SEC filing?

15 MR. WALFISH: Yes, absolutely. We do cite the SEC
16 filing in our complaint. And even if we hadn't cited the SEC
17 filing, although we do, I think the cases are clear that you
18 can't consider deposition testimony but you can consider things
19 in the SEC filings like that, particularly when we have already
20 referenced the filing. But your Honor is absolutely right,
21 those specifics about the number of employees and the square
22 footage of the office space are not actually in the complaint.
23 You're absolutely right about that.

24 THE COURT: I didn't quite get, and I'll hear from Mr.
25 Smith quickly, I didn't quite get exactly what I was supposed

1 to pull out of the deposition. What are the facts that you say
2 would be improper for me to pull out of the deposition that you
3 are concerned with?

4 MR. WALFISH: Your Honor, Rule 12, if you do consider
5 the deposition, I think a fact-finder would see a sufficient
6 basis to conclude that this guy bears responsibility. But you
7 are not supposed to be looking at the deposition on a motion
8 addressed to the pleading. Rule 12(d) of the Federal Rules of
9 Civil Procedure could not be clearer on that point. It says if
10 you consider this deposition, this motion automatically becomes
11 one for summary judgment and we get a chance to make a full
12 evidentiary submission, which we are happy to do at the
13 appropriate time.

14 THE COURT: I'm not sure I clearly understand what it
15 is that you think they are urging me to conclude from the
16 deposition that you say that I should not conclude from the
17 deposition.

18 MR. WALFISH: Judge, I'm sorry, I'm not sure that I
19 understand the question.

20 THE COURT: You raised the issue today that I
21 shouldn't consider things in the deposition in order to support
22 their motion.

23 MR. WALFISH: Yes.

24 THE COURT: Slow down. I'm just asking you, since you
25 raised it, what is it that you think they are trying to urge me

1 to conclude from the deposition?

2 MR. WALFISH: I think I understand your question.
3 You're asking me why did Mr. Smith decide in his reply brief to
4 cite the deposition?

5 THE COURT: No. I'm asking you what is it about
6 citing it, what is it about the deposition that you say he is
7 urging me to conclude that you are concerned is improper to
8 conclude. Are you just making this argument in the abstract
9 procedurally, or is there really something that you are
10 concerned about that he is asking me to take from this
11 deposition that supports his claim that you say I shouldn't
12 accept? Just because Mr. O'Connor said it.

13 MR. WALFISH: Both and more.

14 THE COURT: What is the substance of it?

15 MR. WALFISH: First of all, his citations to the
16 deposition don't show that Mr. O'Connor is an innocent man. If
17 anything, they show the opposite.

18 THE COURT: I know. But what do you care? I'm just
19 asking you specifically in the deposition, is this just
20 rhetoric or is there anything specifically in the deposition
21 that you say he is trying to urge me to utilize as a fact in
22 his favor that you say would be improper for me to conclude
23 that? I don't understand.

24 MR. WALFISH: This is not the time to review evidence.
25 This is a motion addressed to the pleading.

1 THE COURT: I understand that. You're not answering
2 my question. The answer is you don't have a clue as to what he
3 wants me to take from that deposition that he would be arguing
4 that is helpful to him?

5 MR. WALFISH: I read his reply brief, and he is saying
6 that the deposition shows that Mr. O'Connor is an innocent man.

7 THE COURT: In what way?

8 MR. WALFISH: Ask Mr. Smith.

9 THE COURT: In what way are you concerned about me not
10 doing that? You're the one who said, don't do it, Judge.
11 Don't do what?

12 MR. WALFISH: If your Honor accepts the interpretation
13 of this completely improperly submitted deposition record by
14 Mr. Smith rather than the factual interpretation of a
15 deposition that we would offer, then that would be I think a
16 mistake.

17 THE COURT: I don't interpret depositions. I'm just
18 trying to figure out is there a fact that somebody said that
19 you are concerned about that Mr. O'Connor said? Is there
20 something that I should make sure that I don't think I know
21 because I saw it in the deposition that you are concerned
22 about? Or are you just in the abstract arguing that it is
23 improper to consider the deposition?

24 MR. WALFISH: Both.

25 THE COURT: I don't hear you articulating anything at

1 all that is in the deposition that you are concerned I might
2 misuse.

3 MR. WALFISH: Your Honor, I agree with you up to a
4 point. Mr. Smith says that the deposition --

5 THE COURT: Where are you citing from?

6 MR. WALFISH: His reply brief page 7. He says that
7 the SEC has misled the Court through its amended complaint
8 because Mr. O'Connor proclaims his innocence in the deposition.
9 First of all, Mr. O'Connor doesn't proclaim his innocence in
10 the deposition. Second of all, even if he did, this argument
11 would be like saying that if you have indicted a criminal
12 defendant, then the moment that the criminal defendant either
13 pleads not guilty or offers an alibi at trial, instantly the
14 indictment has to be dismissed. It's ridiculous.

15 THE COURT: Your point is simply that I shouldn't
16 conclude that he is not liable, because he said so in his
17 deposition?

18 MR. WALFISH: Yes. Also, if one were to look closely
19 at his deposition, which I don't advise doing, at least at this
20 stage, one will I think reach the opposite conclusion, that he
21 is liable. That's all.

22 THE COURT: Mr. Smith, what is it about the deposition
23 that advances your argument one way or the other?

24 MR. SMITH: Your Honor, I merely cited to the
25 deposition in order to refute the SEC's allegations that

1 O'Connor, and I point this out in the reply, was directly
2 involved or directly participated.

3 THE COURT: Because in his deposition he says he
4 wasn't directly involved?

5 MR. SMITH: Correct. I don't say anything, I don't
6 proclaim, I don't use the word "innocence" at all. I don't
7 remember using that term. That is something that Mr. Walfish
8 just inaccurately stated. We were merely trying to refute the
9 SEC's allegations that he was directly involved or directly
10 participated. We leave it to the Court.

11 THE COURT: Where are we in terms of discovery? What
12 else needs to be done?

13 MR. WALFISH: May I?

14 THE COURT: Yes.

15 MR. WALFISH: Your Honor, at the moment two additional
16 depositions have been scheduled and we anticipate that there
17 may be additional ones. That's what we were trying to convey
18 to the Court.

19 THE COURT: Pretty much substantially the document
20 production has been exchanged?

21 MR. WALFISH: Substantially, yes. There may be
22 disputes, but we don't need to --

23 THE COURT: For the most part you both have most of
24 what there is to have?

25 MR. WALFISH: That's a fair statement.

1 THE COURT: You need to take what kind of deposition?
2 Who's left?

3 MR. SMITH: Lee is left. Connor is left, correct, if
4 I'm not mistaken. Then there may be some other people that the
5 defendants wish to notice. We are still working that out. It
6 could be other employees. We don't know yet. But I know Lee's
7 deposition.

8 MR. WALFISH: Judge, if the Court wants a full factual
9 consideration of O'Connor's guilt or not, we would come forward
10 with another deposition that was taken at which Kevin Cassidy
11 says, yes, Mr. O'Connor was involved. We could come forward
12 with evidence from other witnesses.

13 THE COURT: I'm just trying to figure out whether I'm
14 going to have to be going through this exercise for a third
15 time very soon based on a summary judgment motion. It seems to
16 me that whatever is known in terms of what the proof is going
17 to be is pretty much already known.

18 MR. WALFISH: Much of it, not all of it. Some of it
19 is known. Some of it has yet to be developed in the form of
20 actual testimony or declarations, and so on, of a number of
21 witnesses.

22 THE COURT: Who have not yet been deposed, is that
23 what you are saying?

24 MR. WALFISH: Correct.

25 THE COURT: That's what I'm trying to get a feel for.

1 Who else?

2 MR. WALFISH: If this were a summary judgment motion,
3 which this is not, as opposed to one addressed to the pleading,
4 what we would put in is not just Mr. O'Connor's declaration,
5 incorrectly characterized as exculpating him, we would also put
6 in Mr. Cassidy's deposition inculcating Mr. O'Connor. We would
7 put in statements from other witnesses, declarations, and
8 documents all showing that Mr. O'Connor knew what was going on.

9 THE COURT: You misinterpreted the thrust of my
10 question. My question had nothing to do with that issue.

11 MR. WALFISH: I'm sorry.

12 THE COURT: I just wanted to know where you are in
13 terms of the proceeding. At this point, quite frankly, it
14 seems to me that I'm not going to go back and review this any
15 further. I'm going to go ahead and deny the motion. I think
16 on the record here the amended complaint is as sufficient as it
17 originally was before it was amended to allege a claim against
18 Mr. O'Connor. I'm not going to revisit that. So Mr. O'Connor
19 still must defend against those primary claims.

20 The question of whether or not the government will
21 have an opportunity based on this complaint as it is alleged to
22 present a case of control liability either as an alternative
23 theory or as an additional theory I think remains to be seen.
24 I think the factual allegations in this complaint, and I think
25 at this point I'll only need to make this determination, the

1 factual allegations in this complaint, if the government can
2 prove most or all of these facts, would be sufficient to prove
3 one or the other. That's all I need at this point.

4 Whether or not it's sufficient to prove both or
5 whether or not at the conclusion of discovery one or both
6 should be dismissed on summary judgment, the facts do not
7 support the allegations in the complaint, or whether or not the
8 case goes to trial and the government is forced to choose,
9 based on the facts as they say they intend to prove them, a
10 theory of what they intend to prove depending on what facts
11 they say exist is a different question.

12 In terms of the allegations, the bare minimal
13 allegations that have been made, I think the bare minimal
14 allegations made in this complaint indicate that the
15 government, if they were able to prove what they say they can
16 prove, puts the defendant on notice that they believe that he
17 took action in furtherance of a scheme to defraud that they
18 described as the U-turn scenario and that he was fully
19 knowledgeable about what was occurring, that what was occurring
20 was inconsistent with the representations that he was
21 personally making about the circumstances and inconsistent with
22 what others were making statements about the circumstances, and
23 that therefore if they can prove that he in fact were making
24 representations or allowing people or leading people to believe
25 that a different review and evaluation was being conducted even

1 though they, a number of individuals, were simply knowingly
2 regurgitating facts and recirculating facts that did not allow
3 for any substantial review or check, and if in fact the
4 government is able to prove that they were hired to do
5 otherwise but was misrepresenting or misleading or omitting to
6 indicate in a material way that in fact what the expectation
7 was and promise was not being met, then I think the government
8 will have a theory to sustain such a claim if they convince a
9 jury that such facts exist that would meet the elements of that
10 claim.

11 That theory, as I say, given the way it is alleged,
12 will be minimally at least a theory of either control liability
13 or a theory of actual direct primary liability based on the
14 defendant's own act. Whether or not it will be both, I think
15 that that remains to be seen.

16 I am not ultimately yet convinced that the way it's
17 alleged, the government can proceed separately and get at the
18 same time both types of claims. That I don't think makes the
19 complaint itself fatally deficient. As long as at least one of
20 those theories of liability can be sustained based upon a set
21 of facts that would be consistent and support the allegations
22 that have been made in the complaint, I think the allegations
23 being made in the complaint could put the defendant on notice
24 of a circumstance under which, if the SEC were to be able to
25 prove the allegations as they minimally allege in this

1 complaint, it could sustain liability on the part of Mr.

2 O'Connor.

3 Whether or not that's the case or not, that is not the
4 examination at this point. If it's appropriate as we are
5 nearing the close of discovery to revisit this based on whether
6 or not there is a fact or facts that do support the allegations
7 as made, the fraud allegations, fraudulent conduct allegations
8 made in the complaint, that I can revisit that on a full record
9 and force the government to specifically articulate, based on
10 what specific evidence they believe they would be able to
11 sustain, a claim on the different theories of liability that
12 they are putting forth.

13 Even beyond that, if summary judgment is denied, they
14 still have an opportunity to limit the nature of the proof or
15 the legitimate nature of the proffered claims for a jury's
16 consideration depending on what set of facts are available for
17 the jury to consider. As I always say, you can have
18 alternative theories but you cannot have alternative facts.

19 Only one thing happened. You have to make up your
20 mind what it is that you say the facts demonstrate that
21 happened and figure out whether or not those facts sustain one
22 or both theories or simply is a scenario that if the jury
23 accepts the evidence as proffered by the government, there is
24 only one conclusion that they could validly reach.

25 If that's the case, then the question is simply a

question of determining whether or not the evidence is strong enough to support that conclusion as opposed to, based on the set of facts, a menu of different theories, that if the jury accepts one set of facts, it's one kind of case, and if the jury decides it's a different set of facts, it's a different kind of case. I think that is a heavy burden for the government to articulate.

At this point I'm going to go ahead and I'm going to deny the motion. I think you should just move forward and finish up discovery, decide whether or not there is a basis for summary judgment. We need to get past that. Then we can decide if there is going to be a trial, whether or not appropriate motions in limine would either limit or focus the proof and the issues for the jury, if we get that far.

Based on the complaint itself, consistent with my previous opinion, I think the complaint itself withstands the motion to the extent that the defense motion is that the SEC has failed to state a cause of action, a plausible cause of action, based on the factual allegations in the complaint based on a claim of either primary liability or control liability.

Based on the arguments that I have heard today and review of the papers and those reasons, I'm going to deny the motion to dismiss. I'll issue an order denying the motion for the reasons given and discussed here on the record. Then we will move forward and see whether or not the facts themselves

are consistent and can legitimately sustain the factual allegation as laid out in the original complaint and as amended at this point, as further amended in the amended complaint.

That is going to be my ruling. Go ahead and see how you can expeditiously finish up discovery. See what you need to do to coordinate the evidence. If we need to meet before the February 28th date, we will do so. Otherwise, hopefully you can let me know by that date and time or before that time what would be the next step at the close of discovery, all discovery. Let's try to finish that up as efficiently as possible.

Thank you.

(Adjourned)